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In the Supreme Court of the United States

OCTOBER TERM, 1950

No. 526

THELMA D. PARR AND GEORGE B. PARR, PETITIONERS

v.

FRANK SCOFIELD, INDIVIDUALLY AND AS UNITED STATES COLLECTOR OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The findings of fact and conclusions of law of the District Court (R. 66-74) are reported in 89 F. Supp. 98. Its memorandum opinion (R. 65) is not reported. The opinion of the Court of Appeals (R. 87-90) is reported at 185 F. 2d 535.

JURISDICTION

The judgment of the Court of Appeals was entered on December 7, 1950 (R. 90). The petition

for a writ of certiorari was filed on January 30, 1951. The jurisdiction of this Court is invoked under 28 U. S. C., Section 1254.

QUESTIONS PRESENTED

1. Whether the Court of Appeals erred in holding that the finding of the District Court that taxpayer was not a joint venturer with Hamill & Smith, a partnership, in the development and operation of an oil and gas lease was not clearly erroneous.

2. Whether, on the assumption, contrary to the finding, that taxpayer was a joint venturer in the operation of the lease, the Court of Appeals erred in holding that taxpayer was taxable in any event in 1944 upon the entire amount received in that year pursuant to a judgment awarding him a one-fourth interest in the lease and equipment thereon, and in the net profits therefrom, from the beginning of operations in 1936 to the date of judgment on December 23, 1942.

3. Whether, under Sections 23 (m) and 114 (b)(3) of the Internal Revenue Code, the taxpayer is entitled to a deduction for depletion in 1944 on the amount of net profits received pursuant to the judgment.

STATUTES INVOLVED

Internal Revenue Code:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

* * * * *

(m) *Depletion.*—In the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion and for depreciation of improvements, according to the peculiar conditions in each case; such reasonable allowance in all cases to be made under rules and regulations to be prescribed by the Commissioner, with the approval of the Secretary. * * *

* * * * *

(26 U. S. C. 1946 ed., Sec. 23.)

SEC. 114. BASIS FOR DEPRECIATION AND DEPLETION.

* * * * *

(b) *Basis for Depletion.*—

* * * * *

(3) *Percentage Depletion for Oil and Gas Wells.*—In the case of oil and gas wells the allowance for depletion under Section 23(m) shall be 27½ per centum of the gross income from the property during the taxable year, excluding from such gross income an amount equal to any rents or royalties paid or incurred by the taxpayer in respect of the

property. Such allowance shall not exceed 50 per centum of the net income of the taxpayer (computed without allowance for depletion) from the property, except that in no case shall the depletion allowance under section 23(m) be less than it would be if computed without reference to this paragraph.

* * * * *

(26 U. S. C. 1946 ed., Sec. 114.)

SEC. 182. TAX OF PARTNERS.

In computing the net income of each partner, he shall include, whether or not distribution is made to him—

* * * * *

(c) His distributive share of the ordinary net income or the ordinary net loss of the partnership, computed as provided in section 183(b).

(26 U. S. C. 1946 ed., Sec. 182.)

SEC. 3797. DEFINITIONS.

(a) When used in this title, where not otherwise distinctly expressed or manifestly incompatible with the intent thereof—

* * * * *

(2) *Partnership and Partner.*—The term "partnership" includes a syndicate, group, pool, joint venture, or other unincorporated organization, through or by means of which any business, financial operation, or venture is carried on, and which is not, within the

meaning of this title, a trust or estate or a corporation; and the term "partner" includes a member in such a syndicate, group, pool, joint venture, or organization.

* * * * *

(26 U. S. C. 1946 ed., Sec. 3797.)

STATEMENT

The facts as found by the district court may be summarized as follows:

In 1936, the taxpayer [1] acquired an oil and gas lease in Webb County, Texas, and thereafter transferred the lease to Hamill & Smith, a partnership. Hamill & Smith proceeded to develop and equip the lease, without any participation by the taxpayer. After production was had on the property, the taxpayer claimed that, by oral agreement, he had retained a one-fourth interest in the lease and equipment, and that Hamill & Smith were to reimburse themselves for the taxpayer's one-fourth of the costs and expenses, and were to pay over to him the net income from his interest. Hamill & Smith denied the existence of this agreement. In 1941, the taxpayer instituted suit against them in the Texas courts to recover an "undivided

[1] The consolidated cases involve as taxpayers George B. Parr and his former wife, the income in question having been reported in their separate returns as community property income. For convenience, however, George B. Parr will be referred to as the taxpayer. Since institution of the suits, George B. Parr and Thelma D. Parr have been divorced (R. 76), and are proceeding individually herein.

¼ interest" in the lease and "one-fourth of the profits realized from such" lease. (R. 66-67.)

The taxpayer secured a verdict in the state court, by virtue of which he was awarded an undivided one-fourth interest in the lease and equipment, and one-fourth of the net income from the property from the inception of operations in 1936 to the date of judgment. (R. 59-64.)

After the judgment became final, Hamill & Smith, during February 1944, paid to the taxpayer all funds due under the judgment, together with interest. As a result of the suit, the taxpayer, who had previously assigned a 45 percent interest in the property and the net income to his attorneys, received the following amounts (R. 68):

55% of 25% of net income from the lease—	$165,554.30
55% of 25% (*sic*) of interest allowed on judgment	22,868.58
Total	$188,422.88

Prior to 1944, Hamill & Smith never recognized the taxpayer's claim to an interest in the lease and they reported all the income and expenses of the lease in their income tax returns for those years. (R. 68-69.)

Prior to 1945, the taxpayer did not report any part of the net profits from the lease nor were returns filed prior to 1945 reflecting the existence of an alleged joint venture consisting of taxpayer

and Hamill & Smith. In that year, the taxpayer filed amended returns for the years 1942 and 1943, and included therein one-fourth of the net profits derived from the operation of the lease in each of those years, and paid the additional taxes disclosed on the amended returns. Also, in 1945, the taxpayer filed partnership returns in the name of Hamill & Smith & Parr for the years 1936 to 1943, setting forth the distributable income derived from the operation of the lease in those years. The taxpayer, however, has never reported for tax any part of his net income derived from the operation of the lease from 1936 to 1941, inclusive. (R. 69-70.)

The filing in the year 1945 of partnership returns for prior years was at the suggestion of taxpayer's counsel. The partnership of Hamill & Smith did not know at that time and, so far as the record discloses, did not know at the date of trial that such returns had been filed. (R. 70.)

The Commissioner determined that there should have been included in the taxpayer's 1944 return the amount of income and the fair market value of the lease and equipment acquired by him as a result of the judgment. Consequently, additional amounts of tax were assessed for that year against the taxpayer and his wife. These amounts were paid and the Commissioner rejected timely claims for refund which had been filed. The refund claims alleged that the taxpayer was a member of

a joint venture and that the income was taxable to him in the years when earned by the joint venture, and not in the year of receipt. Alternatively, it was alleged that the taxpayer was entitled to a deduction for depletion with respect to the income received. (R. 70-72.)

Thereafter, the taxpayer and his wife instituted suit to recover the taxes which were alleged to have been erroneously overpaid for the year 1944. (R. 2-10.) The district court decided that the taxpayer and his wife had not overpaid their taxes and dismissed the complaint. (R. 74-76.) On appeal from the dismissal of the complaint, the Court of Appeals for the Fifth Circuit affirmed. (R. 87-90.)

ARGUMENT

1. Whether the taxpayer and Hamill & Smith intended to become joint venturers is a question of fact. *Commissioner* v. *Culbertson,* 337 U. S. 733, 741; *Commissioner* v. *Tower,* 327 U. S. 280, 287; *Lusthaus* v. *Commissioner,* 327 U. S. 293; *Farrell* v. *Commissioner,* 134 F. 2d 193 (C. A. 5), certiorari denied, 320 U. S. 745. The district court found that they were not joint venturers (R. 72), and the court below held that the district court's finding was not clearly erroneous. In so holding, the court below was plainly right.

The fee title to the lease was transferred, without reservation (R. 16, 67), to Hamill & Smith and remained in them until the termination of litiga-

tion in the state court pertaining thereto, in 1944, and the judgment of the Texas district court for Webb County (R. 17, 61-63) was simply that the taxpayer owned a one-fourth interest in the lease and equipment and had a right to receive from Hamill & Smith, the operators of the lease, one-fourth of their net profits from the operation. Hamill & Smith, at all times prior to the time the state court judgment became final, denied that there was a joint venture between them and taxpayer, or that taxpayer had any interest in the lease (R. 18, 67, 69, 72). Taxpayer took no part in the operation or development of the enterprise (R. 41, 67, 72). Hamill & Smith furnished all of the capital for the enterprise (R. 16, 35, 52). In the circumstances, and since taxpayer's equitable interest in the lease was retained, the district court could properly infer that his interest never became a part of the property which the other alleged joint venturers had acquired and exposed to the risks of the business. The district court could also properly infer that taxpayer had no personal liability for the debts of the business, a usual condition precedent to a joint venture. *Joe Balestrieri & Co.* v. *Commissioner*, 177 F. 2d 867 (C. A. 9).

Moreover, it is obvious that Hamill & Smith never intended to enter into the alleged venture with taxpayer, since they never filed partnership tax returns covering it [2] (R. 18). A joint venture

[2] Section 3797(a)(2) of the Internal Revenue Code includes a joint venture within the definition of a partnership.

cannot exist unless the parties intend to associate in that capacity. *Luling Oil & Gas Co.* v. *Humble Oil & Ref. Co.*, 144 Tex. 475, 483-484; *Porter* v. *Cooke*, 127 F. 2d 853, 857-858 (C. A. 5), certiorari denied, 317 U. S. 670. Cf. *Commissioner* v. *Culbertson, supra.* Indeed, taxpayer's suit against Hamill & Smith was not premised on the contention that he was a joint venturer with them (R. 17), and apparently he never asserted that there was such an alleged joint venture until the belated partnership returns were filed by him in 1945 (R. 18-19).

Taxpayer's arrangement with Hamill & Smith was no more than a sublease, with the rent measured by a stated portion of the sublessee's net profits, *i.e.*, he permitted them to use his fractional interest in the lease in consideration for their paying him one-fourth of the net profits and their giving him a fractional interest in the equipment. Thus, there was an abundance of evidence to support the district court's finding that there was no joint venture between taxpayer and Hamill & Smith, within the meaning of Section 3797(a)(2) of the Internal Revenue Code, *supra*, pp. 4-5, or under the local law. See *Luling Oil & Gas Co.* v. *Humble Oil & Ref. Co., supra*, 144 Tex. 475; *Johnson* v. *Murray Co.*, 90 S. W. 2d 920, 923 (Tex. Civ. App.); *Gardner* v. *Wesner*, 55 S. W. 2d 1104 (Tex. Civ. App.). Cf. *Transcontinental Oil Co.* v. *Mid-Kansas Oil & Gas Co.*, 29 F. 2d 323 (C. A. 5).

Plainly, then, the court below did not err in refusing to disturb the finding of the district court that there was no joint venture between taxpayer and Hamill & Smith. See Rule 52(a), F. R. C. P. Petitioners concede (Br. 13) that if there was no joint venture, they were taxable in 1944 on the entire amount awarded by the judgment of the state court.

2. Petitioners' contention (Pet. 5, Br. 9-12) that the decision of the court below is in conflict with *Hamill & Smith* v. *Parr*, 173 S. W. 2d 725 (Tex. Civ App.); *Reynolds* v. *McMurray*, 60 F. 2d 843 (C. A. 10), certiorari denied, 287 U. S. 664; and *Helvering* v. *Armstrong*, 69 F. 2d 370 (C. A. 9), is without merit.

(a) The judgment of the court below approving the district court's finding is not in conflict with *Hamill & Smith* v. *Parr*, 173 S. W. 2d 725 (Tex. Civ. App.). Taxpayer's suit in the Texas court was not based on any theory of a joint venture and there was no allegation that one existed. The findings of the jury (R. 52-59) do not suggest the existence of a joint venture. The judgment of the state trial court was not based on the theory that one existed. (R. 51-64.) The same is true of the decision of the Court of Civil Appeals, with respect to which taxpayer alleges a conflict. The only reference in the appellate court's opinion to a joint venture was with respect only to the procurement

of the lease, not with respect to operations thereunder. *Hamill & Smith* v. *Parr*, 173 S. W. 2d 725, 727, *supra*.

Nor is the decision below in conflict with *Reynolds* v. *McMurray* and *Helvering* v. *Armstrong*, *supra*.[3] Both of those cases arose out of the same leases and agreements, and the facts were dissimilar to those presented in the instant case. There the agreements were not contested and no litigation was necessary to settle questions of title and accounting. Moreover, the agreements provided that the accounting should be made for the proportionate part of the oil and gas produced, not the net proceeds. And in those cases the primary question was whether the advances made by the operating party for capital expenditures were income to the non-operating parties. In the *McMurray* case, the Tenth Circuit held that in the circumstances the non-operating interests could be in receipt of taxable income even where there was no net income payable. Although the court described the parties as joint adventurers, it is clear that the court there was not speaking in terms of a joint venture which would be treated as a partnership for tax purposes, and was not holding that the parties were required

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[3] In G.C.M. 22730, 1941-1 Cum. Bull. 214, 223-224, the Bureau of Internal Revenue repudiated the "joint venture" theory which it had taken in the *McMurray* and *Armstrong* cases. The tax result actually reached in those decisions is, moreover, contrary to the decisions of this Court in *Kirby Petroleum Co.* v. *Commissioner*, 326 U.S. 599, and in *Burton-Sutton Oil Co.* v. *Commissioner*, 328 U.S. 25.

to file partnership returns and be taxed as partners. As indicated, the question presented and decided in the *McMurray* and *Armstrong* cases (the Ninth Circuit in the *Armstrong* case followed the reasoning of the Tenth Circuit in the *McMurray* case.) was quite different from the issue here.

b. The decision below does not conflict, as taxpayer asserts (Pet. 5, Br. 13), with *First Mechanics Bank* v. *Commissioner,* 91 F. 2d 275 (C.A. 3), in holding that taxpayer was not taxable until 1944 on the part of the lease profits paid to him in 1944, even if he be considered a joint venturer. In that case there was no dispute between the parties respecting their relationship, it having been conceded that the taxpayer was a partner, entitled to a share of the firm profits; the only matter in dispute was as to the amount due him. Here taxpayer's right to any part of the lease profits was contested and was not determined until termination of the litigation. Taxpayer received nothing until 1944 and he was then taxable on the full amount, since he reported income on the cash basis of accounting. See *Farrell* v. *Commissioner, supra,* 134 F. 2d at p. 194. Thus, in the case at bar, where it was unknown whether the taxpayer had any rights at all under the lease until the termination of the litigation in the state court, the court below held that the taxpayer's income in question did not derive from the lease but was recovered by litigation. In the *Mechanics Bank* case, on the other hand,

where there was no contest over title to the lease, but only a dispute over the accounting, the court held that the income in question derived from the lease and the joint venture. The distinction between the two cases is clear.

The holding of the court below that the taxpayer's income was recovered by litigation is, of course, plainly correct. Section 182 of the Internal Revenue Code, *supra*, p. 4, in requiring a partner to include in his taxable income his distributive share of partnership earnings, regardless of whether or not distribution is actually made, has no reference to a mere claim to earnings where the very existence of the partnership or joint venture is in dispute. Taxpayer had no right to any property or earnings during the time that Hamill & Smith were actually contesting his claim. Consequently, taxpayer was not a partner entitled to a distributive share of partnership earnings which could be reported as his income under Section 182 until termination of the litigation. Decisions of this Court make it clear that taxpayer had no income until the dispute was settled, and similarly Hamill & Smith were taxable on all of the income in prior years as received under a claim of right and could deduct the amount paid to taxpayer in 1944. *North American Oil* v. *Burnet*, 286 U.S. 417; *United States* v. *Safety Car Heating Co.*, 297 U.S. 88; see the Government's brief in *United States* v. *Lewis*, No. 347, now pending before this Court.

3. The holding of the court below (R. 90) that taxpayer is not entitled to a deduction for depletion on the amount, representing his share of past net profits, received in 1944, does not conflict, as taxpayer asserts (Pet. 5), with *Kirby Petroleum Co.* v. *Commissioner,* 326 U.S. 599. Taxpayer here had no economic interest in oil and gas which was depleted by production until after the litigation was terminated in his favor. His depletable interest in the property and net profits was first established by the judgment of the state court, and he became entitled to depletion only with respect to production from the property after that time. The amount paid by Hamill & Smith as equal to a part of the past profits earned before taxpayer's interest in the property was established did not represent, as to taxpayer, proceeds or profits from the production of oil but rather merely payment of a money judgment. *Massey* v. *Commissioner,* 143 F. 2d 429, 431 (C.A. 5). Cf. *Helvering* v. *Bankline Oil Co.,* 303 U.S. 362, 367.

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be denied.

Respectfully submitted,

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